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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

No. 458

NATIONAL SECURITIES CORPORATION,
SUCCESSOR BY MERGER TO
AMERICAN GAS & ELECTRIC SECURITIES CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

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WILLIAM H. HARDING,
Attorneys for Petitioner.

MILLS & KILPATRICK,
Of Counsel.

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NATIONAL SECURITIES CORPORATION,
SUCCESSOR BY MERGER TO
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v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

MAY IT PLEASE THE COURT:

The petition of National Securities Corporation, Successor by Merger to American Gas & Electric Securities Corporation, respectfully shows to this Honorable Court:

A.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

Petitioner seeks review of a decision of the United States Circuit Court of Appeals for the Third Circuit, rendered July 28, 1943 (R. 72-3), affirming the decision of the United States Board of Tax Appeals which sustained in part a deficiency in income taxes asserted by the Commissioner of Internal Revenue for the year 1936.

The material facts are as follows:

American Gas & Electric Securities Corporation (hereinafter called the taxpayer) was incorporated under the laws of the State of Maryland on June 23, 1925. National Securities Corporation (hereinafter called the petitioner) was incorporated under the laws of Maryland on September 24, 1929. On December 27, 1939, in accordance with the Maryland statutes, the taxpayer became merged into the petitioner, and thereupon the separate existence of the taxpayer ceased and the petitioner became primarily liable for all debts, liabilities and obligations of the taxpayer and succeeded to all of its property, rights, privileges and franchises. The petitioner's principal office is at 880 Bergen Avenue, Jersey City, N. J. The return of the taxpayer for the period here involved was filed with the Collector for the Fifth District of New Jersey. (R. 46-47)

Taxpayer, at all times since its organization and until the merger aforesaid, was a wholly owned subsidiary of American Equitable Assurance Company of New York, a fire insurance corporation (hereinafter called the parent). At January 1, 1936, the taxpayer's issued and outstanding capital stock consisted of 3,000 shares without par value. Taxpayer's sole business was that of investing in securities and the purchase and sale thereof. The fair market value of its net assets at December 31, 1935, amounted to approximately $276,270, the parent having paid $300,000 in cash for taxpayer's stock. (R. 47)

At various times between August 8, 1929, and June 7, 1933, the parent purchased as an investment 3500 shares of the common stock of Standard Gas & Electric Company (hereinafter called Standard) at a cost of $418,780.19, of which 1,000 shares were purchased in August and September, 1929, at a cost of $140,378.06. (R. 47)

The stock of Standard was listed on the New York Stock Exchange, and the fair market value thereof on December 19, 1935, was approximately $6.25 per share. (R. 47)

During January, 1936, the parent sold 2500 shares of said Standard stock in the open market at prices ranging from $7.75 to $9.125 per share. (R. 47) These sales resulted from the decision of the Executive and Finance Committee of the parent's Board of Directors that the corporation should reduce its position as an investor in Standard's common stock. This decision was based upon the following considerations:

(a) That Standard, which was a very highly complex utility holding company (R. 32), was then in the midst of a reorganization under Section 77(b) of the Bankruptcy Act. (R. 28)

(b) The parent's Standard holdings represented its largest utility investment, and the investment in which it had the largest depreciation (R. 28-9), and the directors wanted to "clean up the portfolio." (R. 28-30, 33-35)

After these sales were made, the parent's Executive and Finance Committee decided that there was sufficient prospect of a future rise in the market value of the stock to justify retention of the remaining 1,000 shares. (R. 29-30, 35-36) However, they felt that the stock of a company involved in reorganization under the Bankruptcy Act did not look well in the portfolio of an insurance company and, for this reason, it was decided that the parent should transfer it to the taxpayer in return for additional capital stock of the taxpayer. (R. 30)

On February 13, 1936, pursuant to appropriate resolutions by the directors of the parent and the taxpayer, the parent delivered to the taxpayer the remaining 1,000 shares of Standard common stock (which had cost the parent $140,378.06 in 1929, and which were worth $8,562.50 on February 13, 1936) in exchange for 800 shares of the taxpayers authorized no-par capital stock, having a stated value of $10 per share. (R. 48-50)

At the time of this exchange, no decision had been made by the directors of either parent or taxpayer to sell the 1,000 shares of Standard stock, the subject of the exchange. The only decision reached was for the taxpayer to hold it and await market developments, in the hope that the value would increase. (R. 32-33) At that time, it was impossible to forecast the resulting gains or losses from security sales by either corporation in 1936, and no thought was given by the directors to the question of tax results from future sale. (R. 33) At that time, the parent owned 246 different stocks and bonds, representing 600 or 700 separate purchases, and 129 of these separate purchases had increased in value over cost by an amount aggregating more than $757,000. (R. 38-39) During the period from January 1 to February 13, 1936, the parent purchased 110 different lots of securities and sold 97 different lots; between February 13 and December 31, 1936, it bought 569 different lots and sold 637 different lots. The results of the parent's sales for the year 1936 reflected the following:

Profits	$1,706,683.76
Losses	1,723,376.88
Net capital loss	$16,693.12

In its 1936 federal income tax return, the parent claimed and was allowed (in accordance with sections 117(d) and 204(c)(5) of the Revenue Act of 1936) only $2,000 of such capital net loss. (R. 39-41)

Standard published a comparative statement of its income for the period of twelve months ended September 30, 1935, and for a like period ended September 30, 1936, which comparative statement was received and examined by taxpayer's directors about November 15, 1936. This statement (R. 31-32, 51-52) showed a downward trend of earnings and piling up of preferred dividend arrearages, which indicated to the directors that the common stock's position was getting steadily worse. They therefore decided to "get out of the whole Standard picture", and on December 11, 1936, the taxpayer sold, on the market, the 1,000 shares of Standard at market price, receiving therefor the net amount of $7,175. The proceeds of this sale were kept by the taxpayer, and no part thereof has ever been paid to the parent. (R. 31, 52) The determination to sell resulted from a study of the comparative income statement above mentioned (R. 31-32), and the trend of developments occurring after February in connection with the Standard reorganization. (R. 29-33)

In computing its taxable income for the year 1936, taxpayer deducted as a loss on the sale of said 1,000 shares of Standard stock the amount of $133,203.06, being the excess of the cost to the parent over the amount received by taxpayer on the sale. The Commissioner disallowed the loss claimed on the Standard stock and asserted an income tax deficiency of $39,367.00 against taxpayer. (R. 9-10, 52)

The income and expenses of the taxpayer were accurately recorded in separate books of account kept by it and none of its accounts was commingled with those of the parent. (R. 53)

On appeal by petitioner, the Commissioner's counsel conceded that he was in error in disallowing the entire loss, but contended that, under section 45, the taxpayer's loss should be measured by treating as its basis the value of the Standard stock on February 13, 1936, the date it acquired the same from the parent. The Board and the Court below sustained this contention, thus denying the taxpayer the

right to deduct $131,815.56 of the total claimed loss of $133,-203.06.

B.

JURISDICTION.

The jurisdiction of this Court is invoked under the provisions of the Judicial Code, Section 240, as amended by Act of Congress, February 13, 1925, 43 Stat. 938 (U. S. C. A., Tit. 28, Sec. 347).

C.

THE QUESTION PRESENTED.

Does Section 45 of the Revenue Act of 1936 (26 U. S. C. A., Int. Rev. Acts, 1936, p. 840) authorize the Commissioner of Internal Revenue to disallow, in whole or in part, a loss computed in accordance with the provisions of sections 23, 112 and 113 of the same Act, on a determination by him that the disallowance of such loss is necessary "in order clearly to reflect the income"?

D.

REASON RELIED ON FOR THE ALLOWANCE OF THE WRIT.

The Court below has decided an important question of federal law which has not been, but should be, settled by this Court, in that it has held that section 45 of the Revenue Act of 1936 authorizes the Commissioner, in his discretion, to allocate deductions between related corporations in a manner in conflict with specific provisions of the revenue laws, on a finding by him that the application of such specific provisions does not clearly reflect income. This is a question of continuing importance because the section involved has been continued in force in later revenue acts.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of

this Honorale Court, directed to the United States Circuit Court of Appeals for the Third Circuit, commanding that court to certify and to send to this Court for its review and determination, on a day certain to be named therein, a full and complete transcript of the record and all proceedings in the case numbered and titled on its docket, No. 8172, National Securities Corporation, Successor by Merger to American Gas & Electric Securities Corporation v. Commissioner of Internal Revenue, Respondent, and that the said judgment may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

NATIONAL SECURITIES CORPORATION,
Successor by Merger to
AMERICAN GAS & ELECTRIC SECURITIES CORPORATION.

By_____
Counsel for Petitioner.

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No.———

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SUCCESSOR BY MERGER TO

AMERICAN GAS & ELECTRIC SECURITIES CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

I.

OPINION BELOW.

The opinion of the Circuit Court of Appeals is not yet officially reported, but appears in the record at pages 66 to 72, incl.

II.

JURISDICTION.

The jurisdiction of this Court is invoked under the provisions of the Judicial Code, Section 240, as amended by Act of Congress, February 13, 1925, 43 Stat. 938 (U. S. C. A., Tit. 28, Sec. 347).

III.

STATEMENT OF THE CASE.

A full statement of the case has been given under the heading "A" in the petition for certiorari (pp. 2-6, *supra*), and in the interest of brevity is not repeated here.

IV.

SPECIFICATION OF ERROR TO BE URGED.

1. The Court of Appeals erred in holding that section 45 of the Revenue Act of 1936 authorizes the Commissioner of Internal Revenue to disallow as a deduction a loss computed in accordance with the specific provisions of sections 23, 112 and 113 of the same Act, merely because the Commissioner, exercising the discretion granted him by the terms of section 45, determines that such action is "necessary in order clearly to reflect the income."

V.

STATUTES INVOLVED.

The statutes involved are set forth in the appendix *infra*, pp. 18-20.

VI.

ARGUMENT.

The Court Below Has Decided an Important Question of Federal Law Which Has Not Been, but Should Be, Settled by this Court.

Section 23(f) (Appendix, p. 18) provides that there "shall be allowed" as a deduction to a corporation "losses sustained during the taxable year."

Section 23(h) (Appendix, p. 18) provides that the basis for determining the *amount* of deduction for losses sustained, "to be allowed under subsection (e) * * * shall be the adjusted basis under section 113(b)."

Section 113(b) (Appendix, p. 19) provides that the "adjusted basis for determining the gain or loss from the sale or other disposition of property * * * shall be the basis determined under subsection (a)", with adjustments not here applicable.

Section 113(a)(8) (Appendix, p. 19) provides that the basis of property acquired by issuance of stock in connection with a transaction described in section 112(b)(5) shall be the same as it would be in the hands of the transferor.

Section 112(b)(5) (Appendix, p. 19), which is entitled "Transfer to Corporation controlled by Transferor", provides that no gain or loss shall be recognized if property is transferred to a corporation solely in exchange for stock in the corporation, if the transferor is thereupon in control of the corporation.

All of this language is in terms mandatory and, as applied to the facts of the instant case, clearly means that the taxpayer, American Gas & Electric Securities Corporation, "shall be" allowed a loss on the sale by it of the Standard stock measured by the excess of the cost of that stock to the parent corporation over the amount received by the taxpayer on the sale thereof. There is no other provision of the revenue law dealing specifically with such a transfer of property to a controlled corporation, the subsequent sale of the property, and allocation of gain or loss thereon. The Board of Tax Appeals and the Circuit Court of Appeals, however, held that section 45 empowers the Commissioner to deny this right of deduction in the instant case; in short that section 45 authorizes the Commissioner, if and only if he, in his discretion, deems it appropriate to do so, to adopt some other method of measuring the loss than that which Congress has so carefully spelled out. No other case on record has ever gone so far. Since Section 45 of the 1936 Act has been re-enacted without change in all subsequent revenue laws, it is a matter of great importance to determine whether the construction so placed upon the law is so obviously correct as to justify this Court in refusing to review it.

Section 45 (Appendix, p. 20) purports to authorize the Commissioner to allocate income or deductions in the case of corporations owned by the same interests (as were the parent and the taxpayer here), if he determines that such allocation is necessary in order (a) "to prevent evasion of taxes", or (b) "clearly to reflect the income" of the two corporations. Since the record is clear (see pp. 3-5, *supra*) that this case involved no question of possible tax evasion,[1] and since the Commissioner (R. 71) based his action on a claim that "allocation was necessary in order clearly to reflect income", the question comes down to this:

Where Congress has provided a definite method of allocating the gain or loss on sale, by a controlled corporation, of property acquired, in exchange for stock, from its controlling stockholder, may the Commissioner of Internal Revenue, under the general provisions of Section 45, prescribe a different method of computation and allowance, simply because he believes the statutory method does not produce a result which "clearly reflects" income?

Any one of several methods could, with equal plausibility, have been prescribed by Congress for measuring the tax result of such a transaction here:

(1) Since the general rule is that *cost* shall be the basis for computing gain or loss on sale, Congress could have provided that the taxpayer's basis should be the value of the consideration given by the taxpayer (namely, its own stock) in exchange for the Standard stock. In fact, this is the general rule applied to the acquisition of property for

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[1] The Board of Tax Appeals failed to make any findings of fact concerning the motives which dictated the transfer of the Standard stock, and in its opinion (R. 21) treated such motives as immaterial. The Circuit Court of Appeals affirmed on the "clear reflection of income" theory (R. 71). In any event, the stipulated facts and undisputed testimony, which are summarized at pp. 3-5, *supra*, make it clear that the tax effects could not have been foreseen and were not taken into consideration at the time of that transfer.

stock (in the absence of "control" of the transferee by the transferor).[2]

(2) Since the transfer from controlling stockholder to controlled corporation effected no substantive change in economic ownership, it could reasonably be provided (as Congress did provide in sections 112(b)(5) and 113 (a)(8), Appendix, pp. 18-19, *infra*) that the recognition of taxable gain or deductible loss should be postponed until sale to outside interests, and that the result, measured by original cost to the transferor, should then be reflected in the accounts of the selling corporation.

(3) Congress could have provided a rule that gain or loss on transfer from controlling stockholder to controlled corporation should be measured, for tax purposes by the difference between cost to transferor and value at the time of transfer, and that the transferee should take this value as its basis for computation on subsequent sale to outside interests. This is the method adopted by the Commissioner in the instant case, and his action was approved by the Court below on the theory that the parent sustained the loss when it transferred the Standard stock to the taxpayer. (R. 71)

Congress adopted the second of these three alternatives. In section 202(c)(3) of the 1921 Act[3], it provided that no gain or loss should be recognized on the inter-company exchange, and in section 204(a)(8) of the 1924 Act[3], it provided that the basis for determining gain or loss on sale by the transferee should be the same as would have been the transferor's basis. In explanation of the latter section, the Senate Finance Committee stated[4] that the theory was the

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[2] *Hyatt Roller Bearing Co.* v. *United States*, 43 F. (2d) 1008; *Amerex Holding Co.* v. *Commissioner*, 37 B. T. A. 1169, 1188, aff'd. 117 F. (2d) 1009.

[3] Re-enacted in substance in all subsequent Acts.

[4] Senate Committee Print, 68th Cong., 1st Sess., dated March 6, 1924, "Statement of the Changes made in the Revenue Act of 1921 by H. R. 6715 and the Reasons Therefor", p. 13.

same as that underlying the similar provision as to basis for property acquired in connection with a reorganization, namely, that the provisions of the section "represent the logical counterpart" of the provisions of section 203 which exempted the exchange from taxation.

The Commissioner in the instant case, therefore, has condemned as not clearly reflecting the income a method of computation and deduction which Congress adopted as "logical" by incorporating it in the statute. The Court of Appeals approved this action on the ground that "the Commissioner's action was neither arbitrary nor capricious", and that it is "most reasonable to treat the loss as one which had in fact been sustained by the parent rather than by its subsidiary." (R. 71)

Since there are at least three "reasonable" methods of taxing such a transaction, as above pointed out, the adoption of no one of them would involve "arbitrary or capricious" conduct on the Commissioner's part, if he were clearly given the power to determine the question. If the test adopted by the Board and the Court of Appeals be sound, therefore, the Commissioner in every similar case is at liberty to choose any one of at least three methods of computation, each with different tax consequences, but is not *required* to deviate from the method prescribed by section 113(a)(8). In the instant case, if he had adopted the first alternative above mentioned, the loss would have been $66,425.00[5]; the adoption of the second method would have sustained the loss of $133,203.06 claimed by the taxpayer; and use of the third would have resulted in a loss of $1,387.50. Yet none of these widely varying results could have been disturbed by the courts, if the decision below be correct, because none would involve "arbitrary or capricious" conduct.

Is it reasonable to assume that Congress, in enacting section 45, intended to give the Commissioner this wide lati-

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[5] *i. e.*, value of taxpayer's stock exchanged for the Standard stock, $73,600 (R. 15), less the sale price of $7,175.00.

tude in determining the method of computing gains and losses? The mere statement of this question, we submit, demonstrates the desirability of a definitive answer by this court.

If, on the other hand the Court of Appeals means to say that there can be only one "reasonable" way of clearly reflecting the income, that being the method approved in this case, it becomes necessary to conclude that the method prescribed by Sections 112 and 113 should never be used; that the Commissioner must always treat such an exchange of property for stock as resulting in a loss to the parent, despite the injunction of Section 112 that such loss shall not be recognized; and that he must always allocate to the parent that part of the loss represented by the depreciation in value at the date of exchange, despite the precise requirements of Section 113 that the entire loss be allocated to the subsidiary.

The Court below justified its conclusion (R. 70) by saying:

> "In every case in which the section is applied its application will necessarily result in an apparent conflict with the literal requirements of some other provision of the act. If this were not so Section 45 would be wholly superfluous."

The answer to this, we submit, is that, while Section 45 deals *generally* with the allocation of income and deductions in the case of businesses "owned or controlled * * * by the same interests" sections 23, 112, and 113 deal *specifically* with the precise type of transaction here presented, namely, a transfer of property by one of such "controlled" businesses to the other, and the subsequent sale of the property by the latter. In short, section 113 (read, as it must be, in connection with section 23) is like section 45 to the extent that it lays down a rule for allocating between stockholder and corporation the loss resulting from the sale by a controlled corporation of property acquired from a controlling

stockholder. The only substantial difference between section 113 and section 45 is this: Section 113 deals specifically with one type, and only one type, of transaction, while section 45 is general in terms, dealing with the allocation of all types of income and deduction. It is an elementary rule of statutory construction that, where a general provision, in its most comprehensive sense, might include what is embraced in a particular enactment, the particular statute must be operative, and the general enactment must be limited to those cases within its general language which are not within the provisions of the particular enactment. *United States* v. *Chase*, 135 U. S. 260, 34 L. ed. 117, 119.

While Section 45 may empower the Commissioner to allocate other types of deduction for which Congress has provided no specific rule, he must, in a field where Congress has laid down such a rule to govern transactions with a "controlled" corporation, follow that rule. Otherwise, the specific rule so prescribed would have no force or effect, except at the Commissioner's whim. If Section 45 permits the Commissioner to prescribe some other method of computation because the application of Section 113(a)(8) does not clearly reflect the income, then it would be his duty to ignore that section in *all* cases of this type, except those rare cases where there is no change in value of the property between the date of its purchase by the stockholder and the date of its sale by the "controlled" corporation, in which cases the same result would flow from following either method.

Under the decision below, therefore, so long as Section 45 exists there will never be a case which Section 113(a)(8) could govern, and the reasoning of the Court of Appeals would lead to the conclusion that Section 113(a)(8) is "wholly superfluous."

An interpretation which produces such absurd consequences, we submit, should be reviewed by this Court.

CONCLUSION.

For the foregoing reasons, we respectfully submit that this petition for a writ of certiorari should be granted.

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William H. Harding,
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Mills & Kilpatrick,
Of Counsel.

APPENDIX.

STATUTES INVOLVED.

The pertinent statutes are the following sections of the Revenue Act of 1936 (49 Stat. L. 1648, C. 690) which appear in substance in the corresponding numbered sections of the Internal Revenue Code (53 Stat. L. 1, C. 2), except as since modified:

Sec. 23. Deductions From Gross Income.

In computing net income there shall be allowed as deductions:

* * * *

(f) Losses By Corporations.—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * *

(h) Basis For Determining Loss.—The basis for determining the amount of deduction for losses sustained, to be allowed under subsection (e) or (f), shall be the adjusted basis provided in section 113(b) for determining the loss from the sale or other disposition of property.

* * * *

(j) Capital Losses.—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117(d).

* * * *

Sec. 117. Capital Gains and Losses.

* * * *

(d) Limitation On Capital Losses.—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. * * *

* * * *

Sec. 112. Recognition of Gain or Loss.

(a) General Rule.—Upon the sale or exchange of property the entire amount of the gain or loss deter-

mined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) Exchanges Solely in Kind.—

* * * *

(5) Transfer to Corporation Controlled by Transferor.—No gain or loss shall be recognized if property erty is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * *

Sec. 113. Adjusted Basis for Determining Gain or Loss.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

* * * *

(8) Property Acquired by Issuance of Stock or as Paid-in Surplus.—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction dscribed in section 112(b)(5) * * *, or

(B) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor. * * *

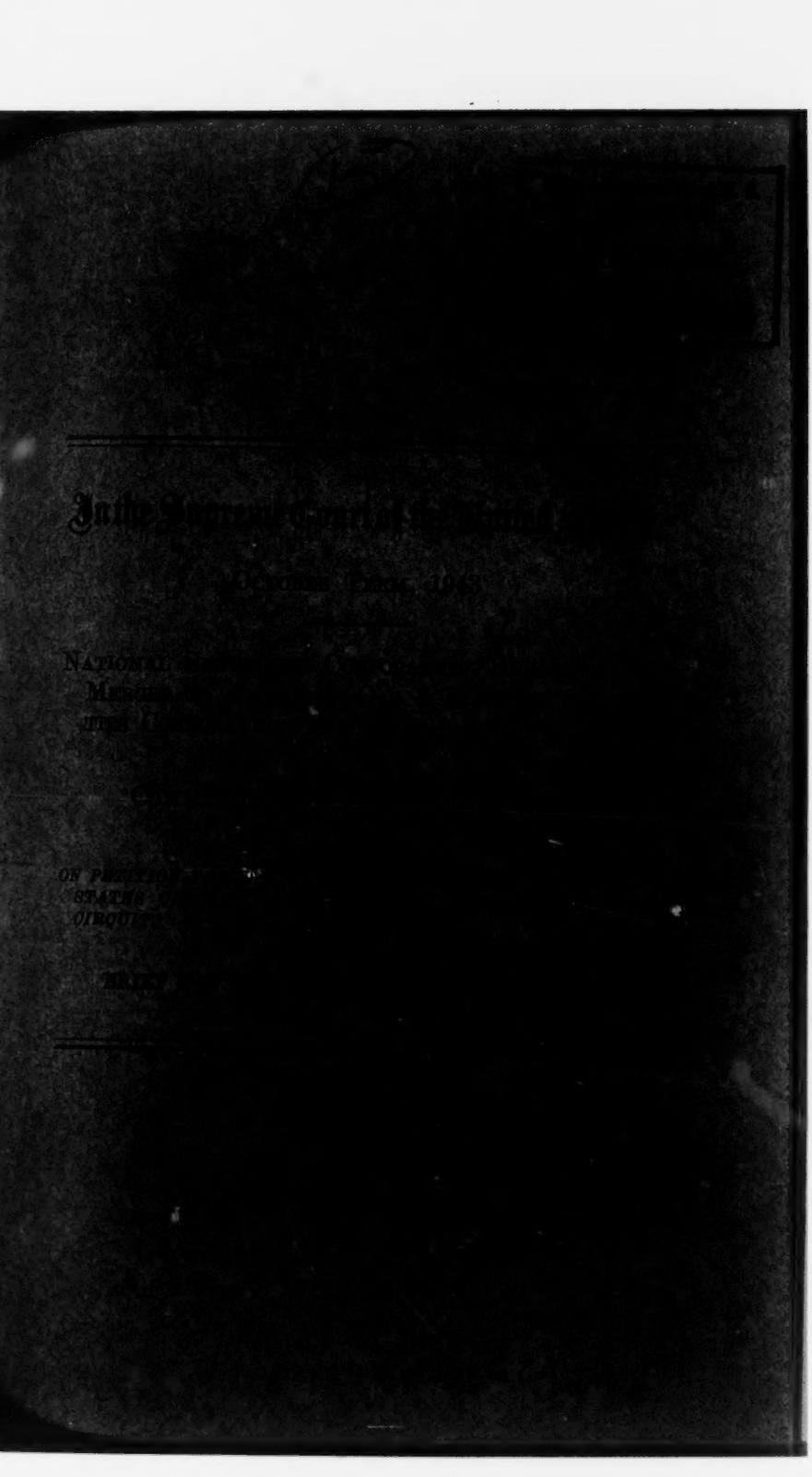
* * * *

(b) Adjusted Basis.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

* * * *

Sec. 45. ALLOCATION OF INCOME AND DEDUCTIONS.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations, trades, or businesses.



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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 458

NATIONAL SECURITIES CORPORATION, SUCCESSOR BY MERGER TO AMERICAN GAS & ELECTRIC SECURITIES CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 13a–22a) is reported in 46 B. T. A. 562. The opinion of the Circuit Court of Appeals (R. 66–72) is reported in 137 F. 2d 600.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 28, 1943 (R. 72–73.) The petition for a writ of certiorari was filed October

26, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Has the Commissioner of Internal Revenue exceeded his authority under Section 45 of the Revenue Act of 1936 in allocating to a parent corporation a portion of a loss claimed by its subsidiary on the sale of stock?

STATUTE INVOLVED

The provisions of the statute involved are set out in the Appendix, *infra*, pp. 10–12.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 14a–16a) may be summarized as follows:

The taxpayer's predecessor, American Gas & Electric Securities Corporation, hereafter referred to as American Gas or subsidiary, was incorporated under the laws of the State of Maryland on June 23, 1925. The National Securities Corporation, the taxpayer, is a Maryland corporation, incorporated on September 24, 1929, with its principal office in New Jersey. In 1939 American Gas was merged with the taxpayer, which succeeded to all the property, rights, privileges, and franchises of American Gas and became liable for all obligations of American Gas. After

the merger the separate existence of American Gas ceased. (R. 14a.)

American Gas was a wholly owned subsidiary of the American Equitable Assurance Company of New York, a fire insurance corporation, hereafter referred to as the parent. On January 1, 1936, American Gas had issued and outstanding capital stock consisting of 3,000 shares without par value for which the parent had paid $300,000 in cash. The fair market value of the net assets of American Gas at December 31, 1935, amounted to approximately $276,270. The sole business of American Gas was investing in, purchasing and selling securities. (R. 14a–15a.)

At the close of the calendar year 1935 the parent owned 3,500 shares of the common stock of Standard Gas & Electric Company, hereafter referred to as Standard, which it had previously purchased at a total cost of $418,780.19. During the year 1935 reorganization of Standard was commenced under Section 77B of the Bankruptcy Act. At the close of 1935 the Standard stock held by the parent had a fair market value of approximately $6.25 per share. (R. 15a.)

During January 1936 the parent sold 2,500 shares of Standard stock in the open market at prices ranging from $7.75 to $9.125 per share. On February 13, 1936, it transferred to American Gas its remaining 1,000 shares of Standard common stock in exchange for 800 shares of the authorized capital stock of American Gas at no

par value. These shares of Standard stock had cost the parent $140,378.06 and had a fair market value on February 13, 1936, of $8,562.50. The American Gas shares given in exchange had a declared value of $10 per share and an indicated fair market value of over $92 per share. (R. 15a.)

On December 11, 1936, American Gas sold the 1,000 shares of Standard common stock, acquired from the parent on February 13, 1936, on the open market, for a net price of $7,175. The selling price was not paid to the parent, but to American Gas. (R. 15a.)

American Gas, in its tax return for 1936, deducted $133,203.06 as a loss on the sale of the Standard stock representing the excess of the cost of the stock to the parent over the amount received by American Gas on the sale[1] (R. 15a-16a).

The Commissioner disallowed the deduction of $133,203.06 claimed by American Gas, and under the provisions of Section 45 of the Revenue Act of 1936 allocated the loss to the parent (R. 16a). He determined a deficiency in tax of $39,367.90 for the year 1936 (R. 7a).

At the hearing before the Board, the Commissioner conceded that the taxpayer was entitled to

[1] The parent's 1936 return discloses an excess of capital losses on the sale of securities over capital gains of approximately $15,600, of which only $2,000 was allowed under the provisions of Section 117 of the Revenue Act of 1936. The parent treated the transaction of February 13, 1936, as falling within Section 112 (b) (5) and accordingly did not claim a loss deduction in its 1936 return. (R. 16a.)

the deduction of a loss equal to the difference between the fair market value of the shares at the time acquired, $8,562.50, and the amount of $7,175, for which they were sold, the difference being $1,387.50 (R. 15a–22a).

The Board held that the extent of the taxpayer's deductible loss was $1,387.50 and that the allocation by the Commissioner of the balance of the loss to the parent under Section 45 of the Revenue Act of 1936 was not arbitrary or capricious but proper under the circumstances of the case. The Board determined a deficiency in tax of $38,916.39 (R. 22a). The Circuit Court of Appeals affirmed (R. 72).

ARGUMENT

There is no conflict and the basic principles underlying the decisions below have been established by many decided cases.

The case involves the power of the Commissioner to apportion or allocate gross income or deductions, under Section 45 of the Revenue Act of 1936 (Appendix, *infra,* p. 11), among controlled corporations and does not involve, as asserted in the petition, the denial of a loss or its computation on a different basis from that prescribed by law.

In enacting Section 45 Congress has conferred broad powers of administrative discretion upon the Commissioner, the exercise of which is not subject to court review in the absence of clear

abuse.[2] That section authorizes the Commissioner to distribute, apportion or allocate "gross income or deductions among two or more organizations, trades, or businesses" "owned or controlled directly or indirectly by the same interests * * * if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations." The purpose of Congress in enacting Section 45 (first appearing in its present form in the Revenue Act of 1928, c. 852, 45 Stat. 791) was to prevent the avoidance of taxes[3] or the distortion of income by the shifting of income or deductions among affiliated companies.

Under the provisions corresponding to Section 45 in prior Revenue Acts,[4] giving the Commissioner power to consolidate the accounts of related trades and businesses for the purpose of making

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[2] *G. U. R. Co.* v. *Commissioner*, 117 F. 2d 187, 189 (C. C. A. 7th); *First Securities Corp. of Memphis* v. *Clements*, 103 F. 2d 1011 (C. C. A. 6th). Cf. *Heiner* v. *Diamond Alkali Co.*, 288 U. S. 502, 507.

[3] Consistent with the evident purpose of the statute, the expression "evasion" of taxes has been held to mean "avoidance" of taxes. *Asiatic Petroleum Co.* v. *Commissioner*, 79 F. 2d 234, 236–237, 238 (C. C. A. 2d), certiorari denied, 296 U. S. 645, rehearing denied, 296 U. S. 664. See *Birmingham Ice & Cold Storage Co.* v. *Davis*, 112 F. 2d 453, 456 (C. C. A. 5th).

[4] Section 240 (d) of the Revenue Acts of 1921, c. 136, 42 Stat. 227; and 1924, c. 234, 43 Stat. 253; Section 240 (f) of the Revenue Act of 1926, c. 27, 44 Stat. 9.

an accurate distribution or apportionment of profits, income, and deductions, the decisions of the lower courts have established the governing principles as to the discretion and powers reposed in the Commissioner.[5]

The taxpayer claims that in applying the general provisions of Section 45 in the instant case the Commissioner has disregarded the specific provisions of Sections 23, 112 and 113 of the Revenue Act of 1936 (Appendix, *infra*, pp. 10, 11–12), which it is asserted, permit the subsidiary to deduct the loss in question. But as pointed out by the Circuit Court of Appeals (R. 68–70) and by the Board of Tax Appeals (R. 20a–21a), the Commissioner has not ignored but followed those specific provisions in determining the amount of the loss which, after determination, has been allocated to the parent company. Section 112 specifies the time when gain or loss is to be recognized for tax purposes and Section 113 provides the basis to be used in determining the amount of gain or loss. Assuming that Section 112 (b)(5) was applicable to the original transfer of the Standard Company shares from the parent corporation to its subsidiary, the Commissioner has used the proper cost basis of the parent in computing the amount of

[5] *Ellison* v. *Commissioner*, 76 F. 2d 509, 510 (C. C. A. 2d); *Nowland Realty Co.* v. *Commissioner*, 47 F. 2d 1018, 1021 (C. C. A. 7th); *Crossett Western Co.* v. *Commissioner*, 73 F. 2d 307, 308 (C. C. A. 3d).

the loss in accordance with the provisions of Section 113 (a) (8).

What the Commissioner has done is, first, to determine the amount of the loss under the applicable statute and, second, to allocate that loss between the subsidiary and the parent in order clearly to reflect the income of parent and subsidiary. Section 45 permits such an allocation in the sound discretion of the Commissioner.

Assuming there was originally a tax-free exchange, the subsidiary has not thereby acquired the undeniable right to take the loss deduction. Section 45 was designed to apply to any case where the transaction and the relationship of the parties is such that the loss properly should be accounted for by the parent rather than the subsidiary. Under the facts of this case it is only reasonable to treat the loss as one which has in fact been sustained by the parent, since allowing the loss to the subsidiary would plainly give an artificial picture of its true net income. That the parent will not receive a tax benefit from the allocation is immaterial. The power to allocate, granted by Section 45, is not dependent upon the allowance of a loss which reduces taxable income.

Moreover, apart from Section 45, the claimed deduction is probably not allowable. *Pennsylvania Indemnity Co.* v. *Commissioner,* 77 F. 2d 92 (C. C. A. 3d), so indicated upon similar facts, and this Court refused further review (296 U. S. 588).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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NOVEMBER 1943.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

(h) *Basis for Determining Loss.*—The basis for determining the amount of deduction for losses sustained, to be allowed under subsection (e) or (f), shall be the adjusted basis provided in section 113 (b) for determining the loss from the sale or other disposition of property.

* * * * *

(j) *Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117 (d).

* * * * *

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does

not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

* * * * *

SEC. 45. ALLOCATION OF INCOME AND DEDUCTIONS.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind*—

* * * * *

(5) *Transfer to Corporation Controlled by Transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock * * * in such corporation, and immediately after the ex-

change such person or persons are in control of the corporation; * * *.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(8) *Property Acquired by Issuance of Stock or as Paid-in Surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) * * * then the basis shall be the same as it would be in the hands of the transferor, * * *.

* * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

* * * * *

SEC. 117. CAPITAL GAINS AND LOSSES.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges.

* * * * *

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IN THE

Supreme Court of the United States

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Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF AMICI CURIAE.

ROBERT STERLING,
IRVING M. ENGEL,
Amici Curiae.

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ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF AMICI CURIAE.

I.

Preliminary Statement.

Counsel *Amici Curiae,* with the consent of the parties, respectfully submit this brief and request that the writ of certiorari sought by the petitioner, National Securities Corporation, be granted.

The citation to the opinion below, the reference to the jurisdiction of this Court and the statement of the case are set forth in the Petition for the Writ of Certiorari and are not repeated herein.

II.

Questions Involved.

A. Does Section 45 of the Revenue Act of 1936 authorize the Commissioner of Internal Revenue to limit deduction of loss by departing from the basis applicable under Section 113 (a) (8), where the property, when transferred in a transaction within Section 112 (b) (5), had a cost in excess of its then value, solely because of the shifting of economic burden thereby effected?

B. If Section 45 may be so applied, is that statute then so arbitrary as to violate the Fifth Amendment to the Constitution?

III.

Summary of Argument.

Section 45 of the Revenue Act of 1936 empowers the Commissioner of Internal Revenue to reallocate items affecting taxable income, in the case of related corporations, to prevent "evasion" of taxes and where necessary "clearly to reflect the income". The facts of this case, as well as the determination of the Commissioner and the opinions of the Board of Tax Appeals and the Circuit Court of Appeals, clearly eliminate "evasion" in the meaning that term ordinarily takes. Nor was there any finding of an intent to "avoid" taxes. However, the Circuit Court of Appeals appeared to sustain the Commissioner on the ground that the greater part of the loss

involved in the property transferred had already been sustained by the transferor and that an "artificial picture" would result if the loss were permitted to be shifted.

The provisions of Sections 112 and 113 of the Revenue Act of 1936, so far as they relate to corporate transactions, were evolved over many years of close study and much judicial scrutiny. As Congress had incorporated loss limitations in the provisions for determining basis as to gifts (and gifts in trust) after consideration of the identical problem, it is clear that there was no intent on the part of Congress to limit losses computed under the basis provision of Section 113 (a) (8) and other like provisions of Section 113 (a), merely because there was a shifting of economic benefit or burden, without more. The action of the Commissioner in this case effects an unlegislated limitation on losses to transferees in such transactions, applied in the arbitrary discretion of the Commissioner. If Section 45 were to be held to grant power to the Commissioner to depart arbitrarily from the statute and without reference to standards laid down in the Act, the Section so construed would be unconstitutional, as in violation of the Fifth Amendment.

IV.

Argument.

A.

Section 45 of the Revenue Act of 1936 does not authorize the Commissioner of Internal Revenue to limit or allocate deduction of loss by departing from the basis applicable under Section 113 (a) (8), where the property, when transferred in transaction within Section 112 (b) (5), had a cost in excess of its then value, solely because of the shifting of economic burden thereby effected.

Section 45 of the Revenue Act of 1936 does not sustain the limitation or allocation by the Commissioner of the deduction claimed by taxpayer.

Section 45, as stated by the Circuit Court of Appeals, below, "Congress has conferred authority upon the Commissioner to allocate deductions 'if he determines' that such allocation 'is necessary'. This is a broad discretion, limited only in that the necessity must arise 'in order to prevent evasion of taxes or clearly to reflect the income.'"

This section involves two considerations:

(a) Meaning of the phrase "evasion of taxes" including particularly consideration of "avoidance".

(b) Meaning of the phrase "clearly to reflect the income".

(a) "Evasion" of taxes is ordinarily taken to mean an attempt to defeat taxes, which, if done willfully, carries with it criminal liability. Section 145 (b), Revenue Act of 1936.

There was no evidence in the Record of any such "evasion" of taxes, nor did the Commissioner of Internal Revenue, the Board of Tax Appeals or the Circuit Court of Appeals draw any inference or suggest or imply the existence thereof.

It was suggested very strongly by the Circuit Court of Appeals for the Second Circuit in *Asiatic Petroleum Co., Ltd.* v. *Commissioner*, 79 F. (2d) 234, 236, cert. den., 296 U. S. 645, 664, that "the phrase 'evasion of taxes' [in Sec. 45] is broad enough to include the avoidance of the realization for taxation of such a profit through its transfer to another branch of the same business enterprise in a way which only changes its place in the business set up." This definition is entirely too broad, in our opinion; certainly the facts of the *Asiatic* case did not require so broad a statement to arrive at the result attained. Even on the assumption that the definition is correct, there must be "avoidance" indicated.

The Commissioner's disallowance of the loss merely referred to Section 45, without more. The Findings of Fact of the Board of Tax Appeals in the instant case make no reference to an intent to avoid taxes. The Board's opinion would seem to indicate that the motive of taxpayer and its parent was immaterial, but then suggests that the petitioner as a business measure would not have transferred "over $73,000 of its own stock for $8,562.50" of securities received from its parent. Since the taxpayer was the wholly owned subsidiary of the parent, the disparity does not seem to rate much consideration.

The opinion of the Circuit Court of Appeals in turn suggests that the Commissioner was not bound to accept the petitioner's explanation as to motives. However, the Court's main thesis seemed to be that as most of the depreciation in value had already occurred while the par-

ent held the stock, an artificial picture would result on the shift of the loss to the subsidiary.

(b) The reference in Section 45 to action by the Commissioner "clearly to reflect the income" involves primarily a determination of what the Congress meant by "income"; it would not seem difficult to determine proper limits to the Commissioner's discretion.

The normal income tax imposed under the Revenue Act of 1936 was based on statutory "net income", Section 13; the surtax relating to undistributed profits was measured by an amount derived from the statutory "net income", Section 14. It has long been pointed out by this Court that deductions, for income taxes, depend on legislative grace. *New Colonial Ice Cream Co.* v. *Helvering*, 292 U. S. 435.

What did Congress have in mind with respect to the term "income" as used in Section 45? Was the intent there to refer to "net income" as a category established in the income tax law, *i. e.*, the "net income" of Sections 13 and 14? Or was the intent to refer to "net income" as used by the accountant or the economist or others? (Cf. Klein, *Federal Income Taxation*, pp. 46-47.)

Assume agreement that "income", as used in Section 45, applies to statutory "net income" for tax purposes. Then the Commissioner may not apply Section 45 to modify an exact computation of statutory "net income", if his sole action then is to reverse a shift, *obviously intended by Congress*, in economic benefit or burden.

The application of Section 45 is indicated without difficulty in other situations; *i. e.*, in the *Asiatic Petroleum Co.* case, *supra*, the taxpayer, which was subject to United States income taxes, sold property to its affiliate, not subject to such taxes, at cost, which was very substantially less than the sale price then immediately secured by the transferee. In *G. U. R. Co.* v. *Commissioner*, 117 F. (2d)

187, the taxpayer purchased from its affiliate at cost to the latter, which was very much above the fair market value at the time, and the Commissioner invoked Section 45 to disallow (as a loss) that excess on the occasion of sale by taxpayer. In neither of these cases did the statute contemplate or intend that the inter-company transfers take effect at other than the then fair market value of the property. But such was the intent of Congress in the instant case.

The early "reorganization" decisions of this Court, culminating in *Marr* v. *United States,* 268 U. S. 536, compelled recognition of gain and loss in corporate transactions which do not now result in such recognition, under Section 112. There was a deliberate departure by the Congress from these decisions, effected by Sections 112 and 113, which expressly contemplated and intended a shift in economic benefit or burden.

The statutory history of Section 113 (a) (8) is very clear and is set forth in the brief of the Petitioner for the Writ. Comparison may well be made with Section 113 (a) (2) and (3). It will be recalled that prior to the amendment of Section 113 (a) (2) effected in the Revenue Act of 1934, there was merely provision for persistence of basis with respect to *gifts* made after December 31, 1920. Section 113 (a) (2) of the Revenue Act of 1932 was amended by the Revenue Act of 1934 to provide that for the purpose of determining loss, the basis should be fair market value at the time of the gift or the basis as otherwise provided in the Section, whichever might be lower. Section 113 (a) (3), relating to *transfers in trust* after December 31, 1920, was not similarly amended in 1934. Upon this being brought home forcefully through the decisions in *Commissioner* v. *Warren Webster Trust No. 1,* 122 F. (2d) 916 (C. C. A.—3) and *Commissioner* v. *Title Guarantee & Trust Co.,* 123 F. (2d) 819 (C. C.

A.—2) the section was amended by Section 143 of the Revenue Act of 1942 to achieve the same limitation.

If the decision of the Circuit Court of Appeals in the instant case remains unreversed, the effect will be that the provisions of Section 113 (a) (8) (so far as transactions under Section 112 [b] [5] are concerned) may be relied upon only when the property has enhanced in value while owned by the stockholder and not in cases where there has been a reduction in value during that period. The broad and explicit language of the two sections just mentioned is applicable whether the asset has gained or lost value while owned by the stockholder. It is clear from the language of those two sections that Congress did not intend for two different rules to be applied. If, therefore, the provisions of Section 113 (a) (8) are to be made applicable only to the cases where the property has not lost value in the hands of the stockholder then that result must be accomplished by Act of Congress and not by arbitrary action on the part of the Commissioner under Section 45. The principle is, of course, of great importance, as it affects every loss not now limited by statute which results from the transfer of property in transactions coming within Sections 112 and 113.

B.

If Section 45 applies in the instant case, then it authorizes arbitrary and capricious action in violation of the Fifth Amendment.

The general rules for computation of taxable income are matters for the Congress. What did Congress have in mind with respect to the term "income" in Section 45? Was the intent to refer to a category established in the law, *i. e.*, the "net income" of Sections 13 and 14 of the Revenue Act of 1936, or was the intent to refer to "in

come" as used for accounting or economic purposes, or to provide for some other basic point of reference? If the first reference, that to "net income" as contemplated by the Revenue Act of 1936, limits the Commissioner, then the provision is clearly constitutional because it sets up known standards binding upon the Commissioner. However, if "income" as it appears in Section 45, may not be defined in terms within the statute, there is an absence of standards for the Commissioner to apply. In the latter case, the provision would be invalid. *Schechter* v. *United States,* 295 U. S. 495.

Counsel urge that when Congress permitted the Commissioner under Section 45 to take action where necessary "clearly to reflect the income", Congress had reference to standards laid down elsewhere in the Act. This means, with respect to those Sections of the Act which provide for deferment of recognition of gain or loss and for the persistence of basis, that their usual application should stand if the sole reason for departing therefrom would be the shift of economic benefit or burden effected by transactions within these Sections. For Congress clearly expected and contemplated such shifting of benefits or burdens.

If the Court below held that the mere shifting of economic benefit or burden was enough to give the Commissioner power to exercise the discretion delegated under Section 45, the Circuit Court was attributing to the Commissioner a power under Section 45 which was "arbitrary or capricious". The Court below has held, in effect, that the Commissioner may choose any other standard than that set up in the statute. Even if such new standard would not be arbitrary or capricious, if adopted by Congress, it remains arbitrary or capricious for the purposes of this case. If this be a sound conclusion, then Congress, as Chief Justice Hughes said in the *Schechter* case,

"by the failure to enact such standards, has attempted to transfer that function to others". In that view, as Mr. Justice Cardozo said in the same case, "The delegated power of legislation * * * is unconfined and vagrant".

CONCLUSION.

For the foregoing reasons, we respectfully submit that the petition for a Writ of Certiorari should be granted.

ROBERT STERLING,
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Amici Curiae.

V.

Appendix.

Revenue Act of 1934:

Sec. 113 (a) (2): "GIFTS AFTER DECEMBER 31, 1920.—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that for the purpose of determining loss the basis shall be the basis so determined or the fair market value of the property at the time of the gift, whichever is lower. * * * "

Sec. 113 (a) (3): "TRANSFER IN TRUST AFTER DECEMBER 31, 1920.—If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a bequest or devise) the basis shall be the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer

under the law applicable to the year in which the transfer was made."

Revenue Act of 1932:

Sec. 113 (a) (2): "GIFT AFTER DECEMBER 31, 1920.—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by fift. * * * "

Revenue Act of 1942:

Sec. 143 (b): "Section 113 (a) (3) is amended to read as follows: 'TRANSFER IN TRUST AFTER DECEMBER 31, 1920.—If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a gift, bequest, or devise) the basis shall be the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made.' "

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v.

COMMISSIONER OF INTERNAL REVENUE.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

PETITIONER'S REPLY BRIEF.

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PETITIONER'S REPLY BRIEF.

Respondent's primary[1] argument is (Br. 7-8) that sec-

[1] Respondent's suggestion that, apart from section 45, the claimed deduction "is probably not allowable" under *Pennsylvania Indemnity Co.* v. *Commissioner*, 77 F. (2d) 92, is patently untenable. In that case, the parent paid to the subsidiary over $666,000 (that being the subsidiary's cost basis) in cash for securities which were worth only about $420,000. Immediately thereafter (partly on the

tions 112(b)(5) and 113(a)(8) merely prescribe a method of *computation* of gain or loss, and do not provide for *allowance* of the amount so computed; and that we must look to section 45 for determination of the extent to which the loss, so computed, may be allowed.

However, this argument ignores entirely the provisions of section 23. That section provides (emphasis supplied) that "in computing net income there *shall be allowed*" as a deduction, "in the case of a corporation, losses sustained during the taxable year," and that the basis for determining the amount of such losses "to be allowed * * * *shall be*" the basis provided by section 113(b). Section 113(b), as applicable to a situation like ours, provides (by reference to section 113(a)) that the basis "*shall be* the same as it would be in the hands of the transferor." The basis of the transferor here was the cost of $140,378.06.[2]

Section 23 therefore clearly provides that, in the case of property acquired as the subsidiary here acquired the Standard stock, the subsidiary *shall be allowed* as a deduction the excess of the parent's cost over the proceeds of sale by the subsidiary. If section 45 be construed as permitting any variation from this rule, there is an apparent conflict with section 23, and the question is presented as to which section shall govern. Since section 23, read in conjunction with section 113(a)(8), applies specifically to a fact situation like that here presented *and to no other,* whereas section 45 is general in its application, petitioner submits that section 23 must govern, under the well established rule of statutory construction discussed at page 16 of our original brief.

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same date) the parent sold these securities in the market, and claimed the loss on its return. The claim was denied, because the excess above market value as paid by the parent was intended to be and was in fact a capital contribution to the subsidiary and not "cost" of the stock to the parent in the ordinary acceptation of that term. The decision has no bearing on a case where, as in the instant case, the transaction involved is clearly covered by the provisions of sections 23(f) and (h) and 113(a)(8).

[2] Sec. 113(a).

Respondent asserts (Br. 8) that "under the facts of this case it is only reasonable to treat the loss as one which has in fact been sustained by the parent, since allowing the loss to the subsidiary would plainly give an artificial picture of its true net income." This contention, if sound would be equally applicable to every case covered by section 113(a)(8) and therefore amounts to an argument that that section should *never* be given effect, because it gives "an artificial picture" of true net income. We submit that it is for the Congress, and not the Courts, to determine such questions of legislative policy.

We further suggest that, for the reasons stated, the decision of the court below may be so plainly erroneous as to warrant a reversal without argument.

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